JUL 23 2001

(23)

No. 00-511

Supreme Court, U.S.
FILED
JUL 23 2001
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

VERIZON COMMUNICATIONS INC., *et al.*,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

MARK L. EVANS
MICHAEL K. KELLOGG
KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

Counsel for BellSouth Corporation, SBC Communications Inc., United States Telecom Association, and Verizon Entities

CHARLES R. MORGAN
JAMES G. HARRALSON
BELLSOUTH CORPORATION
1155 Peachtree Street, N.E.
Atlanta, GA 30309
(404) 249-2641

Counsel for BellSouth Corporation

WILLIAM P. BARR
M. EDWARD WHELAN
VERIZON
1850 M Street, N.W.
Washington, D.C. 20036
(202) 463-5200

PATRICK F. PHILBIN
Counsel of Record
JENNIFER R. BROSNAHAN
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000

MICHAEL E. GLOVER
VERIZON
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-2944

Counsel for Verizon Entities

July 23, 2001 *(Additional Counsel Listed on Inside Cover)*

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

30 pp

ANDREW G. MCBRIDE
SCOTT DELACOURT
KRISTINA R. OSTERHAUS
WILEY REIN & FIELDING LLP
1776 K Street, N.W.
Washington, D.C. 20006
(202) 719-7000

HENRY WEISSMANN
MUNGER, TOLLES & OLSON LLP
355 S. Grand Avenue
Los Angeles, CA 90071
(213) 683-9100

Counsel for Verizon Entities

JAMES D. ELLIS
PAUL K. MANCINI
SBC COMMUNICATIONS INC.
175 E. Houston
San Antonio, TX 78205
(210) 351-3500

ROGER K. TOPPINS
GARY PHILLIPS
SBC COMMUNICATIONS INC.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
(202) 326-8891

Counsel for
SBC Communications Inc.

LAWRENCE E. SARJEANT
LINDA L. KENT
KEITH TOWNSEND
JOHN W. HUNTER
JULIE E. RONES
UNITED STATES TELECOM ASSOCIATION
1401 H Street, N.W.
Suite 600
Washington, D.C. 20005
(202) 326-7371

Counsel for United States Telecom Association

STATEMENT PURSUANT TO RULE 29.6

Petitioners' Rule 29.6 Statements were set forth at pages ii-iii of Petitioners' Opening Brief, and there are no amendments to those Statements.

TABLE OF CONTENTS

	Page
STATEMENT PURSUANT TO RULE 29.6	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
I. THE 1996 ACT DOES NOT PERMIT THE FCC TO IGNORE HISTORICAL COSTS	1
II. TELRIC RAISES SERIOUS CONSTITUTIONAL QUESTIONS UNDER *DUQUESNE*	4
III. NOTHING ABOUT THE ORDER'S "TOTAL EFFECT" CURES TELRIC'S SHORTFALL ..	10
IV. THE AGENCY'S SELECTION OF TELRIC WAS ARBITRARY AND CAPRICIOUS	17
CONCLUSION	20

TABLE OF AUTHORITIES

Cases	Page(s)
ALLTEL Corp. v. FCC, 838 F.2d 551 (D.C. Cir. 1988)	12
AT&T Corp. v. Iowa Utilities Board, 525 U.S. 366 (1999)	16, 19
Blanchette v. Connecticut General Insurance Corps., 419 U.S. 102 (1974)	10
Brooks-Scanlon Co. v. Railroad Commission, 251 U.S. 396 (1920)	13
Citizens Utility Board v. Illinois Commerce Commission, 655 N.E.2d 961 (Ill. App. Ct. 1995) ..	8
City of Detroit v. Detroit Citizens' Street Railway, 184 U.S. 368 (1902)	7
City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978)	10
Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989)	4, 8, 9, 10
Eastern Enterprises v. Apfel, 524 U.S. 498 (1998) ..	8
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944)	8
Field v. Mans, 516 U.S. 59 (1995)	3

	Page(s)
General Motors Corp. v. Tracy, 519 U.S. 278 (1997)	7
In re Permian Basin Area Rate Cases, 390 U.S. 747 (1968)	12
Kaiser Aetna v. United States, 444 U.S. 164 (1979)	8
Michigan Bell Telephone Co. v. Engler, No. 00-2087, 2001 WL 788359 (6th Cir. July 13, 2001)	13
National Ass'n of Greeting Card Publishers v. USPS, 462 U.S. 810 (1983)	3
Potomac Electric Power Co. v. ICC, 744 F.2d 185 (D.C. Cir. 1984)	3
Preseault v. ICC, 494 U.S. 1 (1990)	10, 12
Russell v. Sebastian, 233 U.S. 195 (1914)	7
Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930)	13
Smyth v. Ames, 169 U.S. 466 (1898)	9
Sweet v. Rechel, 159 U.S. 380 (1895)	10
United States v. Dow, 357 U.S. 17 (1958)	10
United States v. Winstar Corp., 518 U.S. 839 (1996)	8
United States Gypsum, Inc. v. Indiana Gas Co., 735 N.E.2d 790 (Ind. 2000)	8

Constitutional Provisions and Statutes	Page(s)
Takings Clause, U.S. Const. amend. V	9, 12
10 U.S.C. § 2688(e)(1)(A)	1
12 U.S.C. § 1713(c)(2)	1
47 U.S.C. § 213(b)	1
47 U.S.C. § 251	14
47 U.S.C. § 252(d)(1)	14
47 U.S.C. § 252(d)(1)(A)(i)	1
47 U.S.C. § 254(d)-(f)	14
Administrative Agency Orders	
Amendment of Rules and Policies Governing Pole Attachments, 15 F.C.C.R. 6453 (2000)	19
In re 1998 Biennial Regulatory Review, 15 F.C.C.R. 242 (1999)	6
In re Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, 12 F.C.C.R. 15982 (1997)	3, 14
In re Access Charge Reform, Sixth Report & Order, 15 F.C.C.R. 12962 (2000)	15

Page(s)

In re Formal Investigation To Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Service in the Commonwealth, No. I-940035, 1994 Pa. PUC LEXIS 15 (May 4, 1994) 8

In re a Methodology to Determine Long Run Incremental Cost, No. U-10620, 156 P.U.R.4th 1 (Mich. PSC Sept. 8, 1994) 18

In re MFS Intelenet of Maryland, Inc., 86 Md. PSC 467, No. 8584, Phase II (Dec. 28, 1995) 3

In re Michigan Telecommunications Act, No. U-11103, 1996 WL 765369 (Mich. PSC Dec. 12, 1996) 3

Verizon Petitions for Pricing Flexibility for Special Access, 16 F.C.C.R. 5876 (2001) 14

Legislative Materials

H.R. Conf. Rep. No. 104-458 (1996) 19

H.R. Rep. No. 104-204 (1995) 4, 19

Texts and Treatises

Black's Law Dictionary (7th ed. 1999) 1

Alfred E. Kahn, *Whom the Gods Would Destroy, or How Not to Deregulate* (2001) 18

Miscellaneous **Page(s)**

FCC, Common Carrier Bureau, Industry Analysis Division, Local Telephone Competition: Status as of December 31, 2000 (FCC May 21, 2001), *at* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0501.pdf> ... 6, 16

Postal Rate Commission, No. R80-1, Opinion (1981) .. 3

Verizon ARMIS 43-01 Report (2000), Table 1, Col. H, Row 1920, *at* <http://www.fcc.gov/ccb/armis> 16

I. THE 1996 ACT DOES NOT PERMIT THE FCC TO IGNORE HISTORICAL COSTS.

The FCC claims that the word "cost" can easily connote a price that would be paid today rather than the amount that was paid or charged in the past. FCC Br. 18. The FCC misses the point.

The term "cost" must be construed in the context of *this statute*. The statute does not set a standard of compensation for a new network yet to be built. Rather, it conscripts a particular set of *existing* assets already built by incumbents. Congress was well aware that incumbents were in the midst of recovering the large capital costs associated with these existing assets through retail rates. Precisely because it was not writing on a clean slate, Congress understood that any compensation mechanism had to address not just forthcoming investment but *investment already made*. For this reason, Congress supplemented the general command that rates be "just and reasonable" with the additional directive that rates "shall be . . . based on *the cost* . . . of providing *the* . . . network element," 47 U.S.C. § 252(d)(1)(A)(i) (emphasis added). Unless mere surplusage, this requirement must *delimit* the FCC's discretion beyond the general call for just and reasonable rates. The only sensible understanding of this provision is that it requires recovery of *all costs* reasonably incurred in supplying UNEs, which here must include past investment.[1]

Where "cost" is used to refer to a large capital asset that an owner has *already built*, the natural connotation includes the amount that the owner has actually expended. That connotation is inescapable where, as here, the term is used to refer to assets for which there is

---

[1] AT&T misleads the Court when it suggests that *Black's Law Dictionary* attributes an exclusively forward-looking meaning to the word "cost." *See* AT&T Br. 17-18 (quoting *Black's Law Dictionary* 349-50 (7th ed. 1999)). The cited definition actually pertains to "replacement cost," and, in fact, the definition of "cost" alone focuses on "the amount paid or charged for something." *Black's Law Dictionary* 349. Limiting adjectives must be used to exclude past expenditure from the plain meaning of "cost." *See, e.g.*, 47 U.S.C. § 213(b) ("reproduction cost"); 10 U.S.C. § 2688(e)(1)(A) ("economic cost"); 12 U.S.C. § 1713(c)(2) ("replacement cost").

no ready market. If Congress had set tolls to recover "the cost of providing the interstate highway system," one would readily understand that phrase to refer to amounts expended to build the existing system, not the virtual costs of redesigning and rebuilding it from scratch today. And if Congress had further provided for an additional "profit" to be included in those tolls, it would be beyond dispute that "cost" must encompass all past expenditures. *See* Verizon Pet. Br. 20-21. Contrary to the FCC's current claim, FCC Br. 22-23, its Order concedes that, "in plain English," a "profit" *presumes* the full recovery of all past expenditures. J.A. 393 (¶ 699).

Moreover, at the time Congress acted, the term "cost" had a settled, technical meaning in the context of telephone utility ratemaking. For over 50 years, "cost" had meant the amount actually expended, *i.e.*, historical cost. As the FCC itself acknowledged shortly before the 1996 Act was passed, historical cost was by then the "normal" and "traditional" ratemaking method. *See* Verizon Pet. Br. 20. It is inconceivable that, in selecting this term, Congress meant to authorize the exclusion of historical cost. The FCC's claim that, by 1996, state regulators were using replacement cost as the sole measure of recoverable costs, *see* FCC Br. 21 (citing J.A. 334-36, 381 (¶¶ 631, 681)), is plainly erroneous. In fact, none of the States cited by the FCC had used forward-looking costs as a price ceiling to preclude recovery of historical costs.[2] Rather, the

[2] In its Order, the FCC cited 14 States that supposedly "already employ[ed], or ha[d] plans to utilize," or merely "support[ed] the use of" "some form" of forward-looking pricing (or LRIC methodology) for UNEs. J.A. 334-36, 381 (¶¶ 631, 681 & nn.1508-12, 1687). But at least seven of these States had used or considered forward-looking pricing only to set price floors to police predatory pricing, *see* J.A. 335 (¶ 631 n.1509) (Colorado, Hawaii, Louisiana, Washington, and Wisconsin use LRIC "as a price floor"); J.A. 381 (¶ 681 n.1687) (Florida TSLRIC "may be appropriate . . . for a price floor"); J.A. 113 (Ohio Comm'n Comments at 47) (LRIC "establish[ed] a price floor for competitive service offerings"). Three other States had not yet decided what role forward-looking costs would play in UNE prices, *see* J.A. 115 (Tex. Comm'n Comments at 26) ("regulators cannot begin to answer pricing questions until incremental cost studies on unbundled network elements are completed and we more precisely quantify the disparity

(Cont'd)

real experience of States in using forward-looking costs was as a tool for determining price *floors* to guard against predatory pricing, or as a device for allocating historical costs among customers — not as a mechanism for denying recovery of historical costs. Nor do price caps represent a departure from historical costs. *See id.* at 31. Rather, price caps are a type of historical cost methodology, *see* Verizon Pet. Br. 3-4, as the FCC has acknowledged in other proceedings, *see In re Access Charge Reform*, 12 F.C.C.R. 15982, ¶ 27 (1997).[3]

(Cont'd)

between embedded and incremental costs"); J.A. 57 (Ariz. Comm'n Comments at 12) (Exhibit V consists only of *proposed* rules); J.A. 334-36 (¶ 631 & n.1510) (Oklahoma had merely "provide[d] for submission of LRIC cost studies"). Three additional States had expressed support for forward-looking measures, but had yet to set UNE prices based on forward-looking costs, *see* J.A. 97 (Cal. Comm'n Comments at 29) ("The CPUC has not yet set its prices for the unbundled elements."); *In re Mich. Telcomms. Act*, No. U-11103, 1996 WL 765369, at *1-*2 (Mich. PSC Dec. 12, 1996) (reviewing staff proposal for determining TSLRIC); *In re MFS Intelenet of Md., Inc.*, 86 Md. PSC 467, No. 8584, Phase II, § II.B (Dec. 28, 1995) (adopting interim UNE rates that, in the aggregate, were based on the incumbent's historical costs). Finally, Connecticut adopted a pricing methodology that took the "existing network and *cost structure* as a given," J.A. 100 (Conn. Comm'n Comments, Att. C at 9-10 (emphasis added)). Moreover, even if some aberrant State had disallowed historical cost recovery prior to 1996, just as in the common law, it is the widely-accepted understanding and usage that governs. *See Field v. Mans*, 516 U.S. 59, 71 n.9 (1995) (looking to "the dominant consensus of common-law jurisdictions rather than the law of any particular State").

[3] The two cases showcased by Respondents as "replacement cost" cases, *see* FCC Br. 19-20 & nn.9, 11; AT&T Br. 19-20, actually involved historical cost recovery. In *Potomac Elec. Power Co. v. ICC*, 744 F.2d 185, 193 (D.C. Cir. 1984), the court approved the use of stand-alone replacement cost because it was higher than historical cost and thus enabled the railroad to recover its fully-allocated historical investment. In *National Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810, 821 (1983), the Postal Service had "responsibility for guaranteeing that total revenues equal total costs," which it had discharged by providing for *full* recovery of *historical* costs. *See* Postal Rate Comm'n, No. R80-1, Opinion at 13-14 (1981). The case involved only the meaning of "attributable cost" as a guide to cost allocation — not "cost" as a standard for overall cost recovery. 462 U.S. at 827-28.

Finally, Congress knew incumbents were recovering past investment through retail rates and expressed its intent that pricing of wholesale services *should not disrupt* existing cost-recovery mechanisms. *See* H.R. Rep. No. 104-204, at 72 (1995). The FCC offers no explanation why the statute would negate that approach in setting compensation for the network elements used to generate wholesale services.[4]

II. TELRIC RAISES SERIOUS CONSTITUTIONAL QUESTIONS UNDER *DUQUESNE*.

In *Duquesne*, this Court upheld a small adjustment within an historical cost regime only after finding that it still preserved the utility's opportunity to fully recover previously invested capital. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 312, 315 (1989). In contrast, TELRIC deprives incumbents of the ability to recover their historical costs, and therefore does not satisfy this standard — a point the FCC concedes by arguing that the standard applied in *Duquesne* was "sufficient, but not necessary" to that decision. FCC Br. 30. Even if the FCC's attempt to rewrite the holding of the case were successful, it would compel this Court to address the "serious constitutional questions" identified in *Duquesne*. *See* 488 U.S. at 315; *see also id.* at 317 (Scalia, J., concurring.). Under principles of constitutional avoidance, the statute cannot be construed to authorize a shift in methodology that requires the Court to resolve these constitutional issues. None of the FCC's tactics to sidestep the constitutional issues is availing.

1. The FCC's feigned agnosticism as to whether TELRIC is higher or lower than historical costs is nonsense. *See* FCC Br. 16-17 & n.8, 37 & n.27. It is indisputable that TELRIC costs are lower than historical costs and thus that UNE rates will not

[4] AT&T incorrectly argues that allowing the incumbent to recover past prudent investment would somehow be "discriminatory." *See* AT&T Br. 23-24. Requiring all users of the network, including wholesale users, to share these real costs in proportion to their use of the network is not "discriminatory." Nor does the argument that the verb "providing" connotes the cost of buying the facility today fare better. *See* FCC Br. 19; AT&T Br. 18. The term "providing" ensures inclusion of operating expenses and costs unique to the provision of UNEs.

permit recovery of past investments. The FCC's own projections are decisive on this point. In the very Order at issue, in setting "proxy prices," the FCC projects the results of TELRIC, J.A. 425-33 (¶¶ 790-798), explaining that these prices "approximat[e]" the results of TELRIC and are so accurate that they should be presumptive ceilings, J.A. 425-26 (¶ 790). The Order projects TELRIC costs that are 60% lower than incumbents' historical costs.[5] Nor could TELRIC have any other consequence, given its assumptions of a hypothetically optimal network coupled with existing cost of capital and depreciation schedules. *See* ILEC Resp. Br. 25-33. Incumbents made submissions demonstrating that blank-slate forward-looking methodologies, including those advanced by entrants, resulted in a substantial revenue gap. *See* J.A. 363-64 (¶ 658). But the FCC rejected the use of historical costs precisely because historical costs yield higher UNE rates than TELRIC, J.A. 383, 398-400 (¶¶ 684, 705, 706).

In its companion Universal Service proceeding, moreover, the FCC corroborated the magnitude of this gap as it determined that TELRIC produces a cost for building the entire local exchange infrastructure — $180 billion — that is barely one-half of incumbents' historical investment of $342 billion. Verizon Pet. Br. 10-11 & n.6. Notably, the FCC, unlike its confused supporters,[6]

[5] Because incumbents' overall retail revenues were set to recoup historical costs, their historical costs can be fairly approximated by gross revenues minus retailing costs. *See* Verizon Pet. Br. 10 n.4. Thus, the FCC's criticisms based upon cross-subsidies among individual rates and the inclusion of retailing costs are irrelevant. *See* FCC Br. 37 n.27.

[6] AT&T and WorldCom make an elementary conceptual error in comparing TELRIC's total construction cost to the unrecovered portion of incumbents' actual investments. *See* AT&T Br. 9-10; WorldCom Br. 29-30. The relevant figures for comparison are annual depreciation expenses. Because TELRIC retains existing depreciation schedules, a network that costs $342 billion will have annual depreciation expenses roughly double those of a network that costs $180 billion. For example, if one assumes straight-line depreciation over 10 years, the first network would result in $34 billion per year of depreciation expenses and the TELRIC network would result in only $18 billion. TELRIC thus cuts incumbents' cost recovery in half.

does not dispute the magnitude of the gap shown by these figures (except to make the empty assertion that the Universal Service proceeding is "distinct," FCC Br. 36-37).[7] In any event, the precise magnitude of the shortfall is irrelevant here. All that is relevant is that TELRIC was projected to result in a systematic shortfall.

This case thus involves an ever-expanding removal of prudent capital investment in used and useful plant from an existing regime that allows its recovery to a new regime that categorically denies its recovery. *Each UNE taken* results in the movement of half of the incumbent's embedded investment from the recoverable to the unrecoverable side of the ledger. The prudent investment excluded by this regime is open-ended and already substantial. Incumbents had already lost 5.3 million lines nationwide as of year-end 2000, and this number was increasing at a 257% annual growth rate.[8] Half the remaining capital investment in these facilities already has been stranded. In fact, the losses are even larger. Because 20% of local telephone customers generate 80% of revenues, even a 5% line loss can produce a revenue loss of 20%. But the magnitude of facilities ultimately shifted to UNEs is irrelevant; the "take rate" goes only to *how much* recovery is precluded, not to *whether* recovery is precluded. From a constitutional standpoint, what is relevant is that TELRIC denies recovery of prudent capital investment, whatever the scale of the plant ultimately shifted.

[7] The FCC makes a different error. Contrary to its statement in the Order under review, J.A. 364-65 (¶ 659 n.1633), the FCC now contends that "incumbents' facilities are, as a general matter, no longer underdepreciated," FCC Br. 38. In fact, the very source that the FCC cites for this proposition acknowledges that, if incumbents were allowed to use the same depreciation lives for regulatory purposes that they use for financial reporting, "they could immediately show over $34 billion in apparent depreciation reserve deficiencies." *See In re 1998 Biennial Regulatory Review*, 15 F.C.C.R. 242, ¶ 64 (1999).

[8] *See Local Telephone Competition: Status as of December 31, 2000*, at 2 & Table 4 (FCC May 21, 2001) ("*Local Competition Status*"), *at* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0501.pdf>.

2. The FCC's core argument is that incumbents have no right to recover prudent past investment. In its Order and Brief, the FCC asserts that incumbents are due only the "fair market value" of their facilities and that TELRIC provides this by predicting what those facilities would be worth in a competitive market. J.A. 422-23 (¶ 740); FCC Br. 35-36. In the agency's view, the fact that TELRIC denies recovery of past investment is "of no constitutional significance." FCC Br. 29. The FCC's argument here — that TELRIC standing alone is an adequate measure of compensation — is conceptually distinct from its later argument, refuted in Section III *infra*, that TELRIC's shortfall is otherwise cured by the Order's "total effect." Here, the FCC must show that TELRIC would yield a constitutionally sufficient return if it were applied to an incumbent's entire business, or, to like effect, to the UNE business "in isolation." FCC Br. 13, 14, 33, 35-36. As shown below, the FCC's argument is devoid of merit. But, at a minimum, the Court would be required to break new constitutional ground to uphold the radical methodological switch embodied in TELRIC.

a. The FCC invokes the commonplace that ratemaking agencies have broad discretion. But this is not a case about the agency's methodological latitude *before* investment is made, where investors are free to invest or not, and are being paid in advance for any risk of non-recovery. This case concerns the propriety of a shift in methodologies *after* investment has been made, where investors have never been paid for any risk of non-recovery.

The basic terms of the regulatory compact are well settled. Where the government has induced investors to dedicate capital to an ongoing utility enterprise, it has created (explicitly or implicitly) reasonable, investment-backed expectations that rates will be set to provide an opportunity to recover capital and a reasonable return. *See, e.g.*, *General Motors Corp. v. Tracy*, 519 U.S. 278, 294-97 (1997); *Russell v. Sebastian*, 233 U.S. 195, 204 (1914); *City of Detroit v. Detroit Citizens' Street Ry.*, 184 U.S. 368, 384 (1902). Without that governmental quid pro quo, the massive investments and service obligations undertaken by utilities

would be economic "madness." *See United States v. Winstar Corp.*, 518 U.S. 839, 910 (1996) (plurality opinion). Many States have *expressly* acknowledged the binding nature of this regulatory bargain.[9] This Court has vindicated expectation interests based on significantly less formal relationships with the government. *See, e.g., Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979).

Thus, fair market value has no application here. *See* Verizon Pet Br. 26-31. As *Duquesne* recognizes, once investment has been induced under rules that promise a fair opportunity to recover capital, investors have a legitimate expectation that they will have that opportunity. The harsh retroactivity of a midstream shift is manifest: the public has reaped all the benefits of lower, stable rates, while investors were never paid for the risk that recovery would be based on the continuous revaluation of assets rather than on the steady value of dedicated capital. The FCC is acting like a car owner who waltzes into a bank and tells the loan officer that henceforward his monthly payments will be based only on the Blue Book value of his car, rather than on the amount of capital he borrowed. *See Eastern Enters. v. Apfel*, 524 U.S. 498, 548 (1998) (Kennedy, J., concurring in the judgment).

Further, no business can live on TELRIC alone. It is not "sufficient to assure confidence in the financial integrity" of the UNE business, "so as to maintain its credit and to attract capital." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). No rational investor would take a debt or equity stake in an incumbent's "UNE business" — an enterprise doomed to continuing write-offs of prudent capital investment, enormous regulatory risks,

[9] *See, e.g., United States Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 797 (Ind. 2000) ("The bedrock principle behind utility regulation is the so-called 'regulatory compact' which arises out of a 'bargain' struck between the utilities and the state."); *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 655 N.E.2d 961, 971 (Ill. App. Ct. 1995) ("[W]e are . . . aware of the special rights and obligations arising from the regulatory compact between the public and investor owned utilities."); *In re Formal Investigation*, No. I-940035, 1994 Pa. PUC LEXIS 15, at *1 (May 4, 1994) ("the regulatory compact [was] struck between the industry and government in the early part of the 20th century").

and depreciation schedules and a rate of return appropriate to a closed market.

b. Besides its inapplicability, the FCC's "fair market value" argument fails because there is, in fact, *no market*. TELRIC is an entirely imaginary construct based on speculation about a non-existent market and network. If the Fifth Amendment's "just compensation" guarantee is to have any meaning, it must refer to an objective standard, independent of the government's self-interested opinion. It turns the constitutional safeguard on its head to permit the government to conjure up and dictate an imaginary "market value" where no market exists. *See* ILEC Resp. Br. 38-41.

This Court has never suggested that imaginary "replacement cost" can be treated as a real market value and used as the sole determinant of cost recovery. Contrary to Respondents' implication that the old "fair value" test is a synonym for replacement cost, *see* FCC Br. 19-20 & n.10; AT&T Br. 30-31, this Court stressed that replacement cost analysis could be only one factor and that historical and opportunity costs had to be given due weight. The "value" that was "fair" was expressly *not* replacement cost by itself. *Smyth v. Ames*, 169 U.S. 466, 546-47 (1898). But the FCC has made its hypothetical modeling the sole determinant of compensation and untethered it from any objective measure of cost by imagining a blank-slate redesigned network. *See infra* n.15. This leaves the Court with no standard to determine whether compensation is just. *See Duquesne*, 488 U.S. at 317 (Scalia, J., concurring).

c. The FCC's remaining constitutional arguments are makeweights. First, it implausibly claims that there is no "switch" here because the compelled lease of UNEs is a "new" business. FCC Br. 31-32. But UNEs are *not* "new" facilities. They are the same facilities whose historical costs incumbents had been recovering through retail rates. For each UNE taken, there is a shift in the method of cost recovery. Second, the FCC alludes to provisions of the 1996 Act under which prior restrictions on long-distance competition must be lifted if an incumbent shows that it has eliminated competitive concerns by fully opening its local markets. *Id.* at 32. The claim seems to be that this is a gift

the FCC may offset by undercompensating incumbents for their UNEs. But once incumbents have removed the basis for the prior restriction, they have the same right to compete as any other company. The right to participate in competitive markets is "the fundamental principle governing commerce in this country," *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 398 (1978), not a governmental gift. Even if it were a "gift," any quid pro quo must be defined in the statute itself — which plainly is not the case here.

III. NOTHING ABOUT THE ORDER'S "TOTAL EFFECT" CURES TELRIC'S SHORTFALL.

The FCC projected that TELRIC would result in rates insufficient to recover incumbents' past investment, and rejected every proposal to address this shortfall on the ground that incumbents were not entitled to those costs. To avoid the principles recognized in *Duquesne*, the FCC now argues that, even if UNE rates are non-compensatory, the Order's "total effect" cures TELRIC's deficiency, because either: (a) Paragraph 739 states that the FCC did not "completely foreclose the possibility" that the FCC *might* address the deficiency later; or (b) Paragraph 737 suggests that other revenues from incumbents' interstate businesses could be "considered." FCC Br. 28, 33-35, 40.

As a threshold matter, both arguments ignore the central mission of an agency in framing a rate methodology. When the government conscripts property, it must make clear and certain provision for adequate compensation *at the time of the taking*.[10] When a utility's property is dedicated to service, the government meets this obligation by clearly declaring at the outset the standard by which the adequacy of compensation shall be measured. Setting this standard is how the government promises

[10] *Preseault v. ICC*, 494 U.S. 1, 11 (1990) ("reasonable, certain and adequate provision for obtaining compensation at the time of the taking" (internal quotation marks omitted)); *Blanchette v. Connecticut Gen. Ins. Corps.*, 419 U.S. 102, 124-25 (1974) (quoting *Cherokee Nation v. Southern Kan. Ry.*, 135 U.S. 641, 659 (1890)); *United States v. Dow*, 357 U.S. 17, 21 (1958); *Sweet v. Rechel*, 159 U.S. 380, 402 (1895).

to pay for using a utility's property. Ratemaking is thus inherently teleological. Verizon Pet. Br. 38. The ratemaker must define the target in advance (the costs to be recovered) and then project that its methodology will achieve this level of recovery. The "total effect" of an order is what the agency has *projected* as an acceptable outcome at the time of its adoption.

A utility can challenge a methodology on the grounds that the outcome the agency projected as acceptable does not meet the constitutional standard. This is the heart of Petitioners' claim. Verizon Pet. Br. 38-39. The agency cannot avoid this constitutional claim by contending that it has not determined what the target of compensation should be or that it is uncertain as to the outcome of its methodology. Just as the government cannot take over someone's living room with vague statements that it "will think about paying," it cannot conscript a utility's property into service based on evasions that it "might consider payment" or that it "will play things by ear."

1. Contrary to the FCC's assertion, FCC Br. 28, nothing in Paragraph 739 retreats from the agency's consistent position that incumbents are not entitled to recover their historical costs. In fact, the Paragraph offers no concession at all. The first sentence says that an incumbent may "seek relief" if it can specifically demonstrate that the rates are "confiscatory." J.A. 422 (¶ 739). But the FCC had just concluded that a rate that prevents recovery of past investment is *not* confiscatory. J.A. 420-21 (¶ 736). On its face, this does not offer even the possibility, much less the assurance, of "relief" from the stranding of historical investment. The second sentence of Paragraph 739 says that the FCC does not "completely foreclose the possibility" of providing "some" recovery. J.A. 422 (¶ 739). This provides no assurance of relief and, even if it did, an after-the-fact remedy is meaningless without a firm commitment to the standard of compensation that will inform its exercise. If the vague musings in Paragraph 739 qualify as "reasonable, certain and adequate provision for obtaining compensation at

the time of the taking," *Preseault*, 494 U.S. at 11, then the Fifth Amendment guarantee is empty.[11]

2. The FCC next claims that, while UNE rates are not sufficient, unspecified "revenue for other services" may be "considered." J.A. 421 (¶ 737). The FCC's Brief claims that incumbents' interstate businesses have "healthy" aggregate returns, suggesting that money must be available as a cross-subsidy to pay for the shortfall on UNEs. FCC Br. 29. This assertion fails on two grounds: (1) reliance on interstate revenues to cross-subsidize inadequate UNE rates is prohibited by the Constitution and the 1996 Act; and (2) the conclusory assertion that other revenues might be available does not satisfy the dictates of reasoned decisionmaking.

A vague allusion to "other revenues" does not constitute an effective cross-subsidy. Where the government insulates a utility from competition, a regulator may set the price of one product below cost as long as it "pays" for the shortfall by *creating* a sufficient cross-subsidy from another product. But to justify below-cost pricing on this ground, two conditions must be met. *First*, the regulator must be responsible for generating a supra-compensatory margin over and above what would otherwise be due on the subsidizing product. Thus, the regulator must actually have the capacity to create

[11] Contrary to AT&T's suggestion, AT&T Br. 28, Paragraph 739 does not remotely resemble the waiver procedure in *In re Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). In *Permian Basin*, there was no dispute that historical cost was the appropriate standard of recovery. The FPC used averages derived from actual cost data from pertinent areas, *id.* at 761, and made a "waiver" available for particular producers to show that their costs exceeded those averages, *id.* at 770-71. The waiver procedure was thus a refinement to reach the *agreed* target of historical cost. Here, the dispute is whether the government has selected the right target. An agency cannot cure a systemic deficiency by vaguely offering the possibility of individual waivers. *See, e.g., ALLTEL Corp. v. FCC*, 838 F.2d 551, 561 (D.C. Cir. 1988). Neither Paragraph 739 nor any other portion of the Order suggests that an incumbent could obtain a "waiver" of TELRIC *because* it denies recovery of historical costs. Further, because the FPC allowed a dissatisfied firm to cease production, 390 U.S. at 772-73 & n.39, *Permian Basin* was a voluntary price ceiling case — not a forced-production case such as this case. *See* ILEC Resp. Br. 36-37.

new incremental revenue — which it does in a closed market — and use that capacity to generate and protect a supra-compensatory margin. *Second*, the regulator must make a reasoned determination that subsidizing revenues are available and adequate, and must calibrate the two revenue pools to ensure sufficient and predictable compensation in both lines of business.

The FCC thus fundamentally misconceives what it means for activities to be "regulated" — *i.e.*, made regular — for purposes of the *Brooks-Scanlon* principle. Contrary to the FCC's assumption, the regulator cannot claim credit for revenues from all activities that it *burdens* with regulation, but only from those activities that it *benefits* by ensuring increased returns.[12] For this reason, a regulator may not rely on competitive revenues or revenues from another sovereign's jurisdiction. *Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396, 399 (1920); *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 160-61 (1930); *Michigan Bell Tel. Co. v. Engler*, No. 00-2087, 2001 WL 788359, at *4 (6th Cir. July 13, 2001) (under *Brooks-Scanlon*, diversified enterprises cannot be "required to subsidize their regulated services with income from rates either deemed to be competitive, or with revenues generated from unregulated services"). Those revenues are already providing the compensation due in those respective lines of business, and the regulator lacks capacity to generate additional margins beyond compensatory levels.

Neither of the two conditions discussed above is remotely satisfied here. The FCC casually refers to the overall returns on incumbents' combined interstate business. FCC Br. 29 & n.17, 34-35. But it plainly violates *Brooks-Scanlon* to rely on overall interstate revenues. Incumbents' interstate businesses are not monolithic, but include lines of business (*e.g.*, long distance,

[12] A government requirement that GM sell Chevrolets below cost cannot be justified by the profitability of Cadillacs, even though the government "regulates" Cadillacs by establishing vehicle safety and emissions standards. Nor could the government claim credit for GM's Cadillac revenues by "regulating" the maximum price that GM can charge for Cadillacs. In neither case is the government responsible for generating the Cadillac revenues.

business data and "special" access) that were competitive well before the 1996 Act. These services comprise a large portion of interstate revenues (some 40% in the case of Verizon). The FCC has formally "deregulated" much of these revenues. *See, e.g.*, *Verizon Petitions for Pricing Flexibility for Special Access*, 16 F.C.C.R. 5876 (2001). Incumbents also face competition on consumer switched access charges (which the FCC still subjects to price caps), particularly with respect to the narrow segment of "high value" customers who disproportionately generate that revenue. In New York, for example, Verizon has already lost more than 25% of its switched access revenue to competitors.

Moreover, the revenue from access charges is already spoken for. Those revenues are unavailable, not only because they are subject to competition, but also because the premise of the 10-year price cap regime is that resultant returns are *compensatory* and yield no "excess." Price caps involve their own regulatory bargain — if the carrier exceeds imputed efficiency levels, it has *earned* a higher rate of return. By definition, that return is necessary to compensate for risks inherent in a price cap regime. *See In re Access Charge Reform*, 12 F.C.C.R. 15982, ¶ 26 (1997). A regime that retroactively declares some of these revenues "excess" and applies them to cover shortfalls elsewhere breaches this bargain. It reduces the return on the access business below the level previously judged compensatory — and leaves no standard to assess the sufficiency of compensation.

The creation of a new cross-subsidy to cover TELRIC's shortfall is also antithetical to the Act. Congress recognized that implicit cross-subsidies are not sustainable in competitive markets and directed their elimination, *see* 47 U.S.C. § 254(d)-(f), and further directed that the UNE business pay for itself, *see id.* § 252(d)(1). Further, UNE rates that rely on cross-subsidies embedded solely in incumbents' prices expose incumbents to cherry picking and therefore violate Section 251's requirement that UNE rates be "non-discriminatory." The notion

that Congress intended incumbents' retail customers to subsidize UNEs for the benefit of competing carriers' shareholders is nonsense.

The FCC's purported reliance on a cross-subsidy is also completely arbitrary, given that the agency has taken the position that any shortfall should be recovered through a "competitively neutral" mechanism that is "separate from rates," FCC Br. 40; J.A. 422 (¶739), such as a non-bypassable end-user charge. Thrusting UNE costs on retail customers — rather than allocating them to UNE users — clearly "warp[s] the course of competition," FCC Br. 40, and is directly contrary to the agency's rationale for excluding them from UNE prices in the first place. *See* J.A. 399-400 (¶706).

Even if cross-subsidies were permissible, calling incumbents' interstate revenues "healthy," FCC Br. 29, in a legal brief is not reasoned decisionmaking. The FCC has not projected how much revenue is needed, identified which *categories* of interstate revenues are available, or determined how much "excess" revenues particular interstate services generate. The last determination would require the agency to arrive at appropriate rates of return for various interstate services now subject to competition. Because the FCC has never made this finding, it has no standard for determining what revenues, if any, are "excess." The retroactive imposition of any particular rate of return on the access business — let alone the 11.25% return established for a monopoly environment — is wholly inconsistent with a price cap regime. Finally, the FCC has never purported to calibrate access charges to cover the burgeoning losses of the UNE business. On the contrary, in its access charge orders, the FCC set access rates without regard to UNE losses and has, in fact, *reduced* access revenues to cover *only* the costs of those services. *In re Access Charge Reform, Sixth Report & Order*, 15 F.C.C.R. 12962, ¶¶ 3, 20 (2000).[13]

---

[13] Even if a cross-subsidy were permissible, the whole pot of interstate revenues is inadequate to compensate for the below-cost UNE

(Cont'd)

The FCC's blithe invocation of the "financial integrity" test is meaningless. As shown above, that standard cannot be applied to a company with diversified lines of business subject to competition and to the jurisdiction of multiple sovereigns, as the FCC attempted to do in Paragraph 738 of its Order. J.A. 421-22 (¶ 738). Nor is the FCC's cause aided by its present claim that it was referring solely to the "financial integrity" of interstate operations.[14] First, as explained above, incumbents' interstate revenues plainly include unavailable competitive revenues. Second, unless and until the FCC defines which interstate lines of business it is relying on to augment UNE rates,

---

(Cont'd)
rates. First, the mounting UNE costs are already huge in relation to the size of overall interstate revenues. Interstate revenues are set to recover 25% of incumbents' total costs. Verizon has already turned over 6% of its lines as UNEs. *See Local Competition Status*, Table 6. Thus, the aggregate "UNE rate base" is already approaching one-quarter the size of the interstate rate base. Second, the aggregate interstate earnings are irrelevant. It is the individual operating companies (which issue their own bonds) that must be able to project earnings satisfactory to the capital markets. The fact that Verizon's New York telephone company has an interstate return — even without consideration of the new "UNE rate base" — of a meager 5.18%, *see* Verizon ARMIS 43-01 Report (2000), Table 1, Col. H, Row 1920, *at* <http://www.fcc.gov/ccb/armis>, refutes the notion that there are "excess" interstate revenues.

[14] In its Order, the FCC categorically stated that it "may not consider incumbent LECs' revenue derived from services not under our jurisdiction." J.A. 421 (¶ 737 n.1756) (citation omitted). One paragraph later, the agency contradicted itself by purporting to consider incumbents' "financial integrity" in all their operations. J.A. 422 (¶ 738). Before this Court, the FCC again plays both sides of this issue. First, it disclaims any reliance on intrastate retail revenues, FCC Br. 34 n.24, but later intimates that incumbents' total revenues from *all* services "could" be counted, *id.* at 35 n.25. Still later, the agency cannot restrain itself from citing "local retail rates" to supplement TELRIC. *Id.* at 38. The FCC was right the first time — it has no jurisdiction over intrastate retail revenues and therefore cannot make them part of an interdependent rate regime. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 381 n.8 (1999).

and what rates of return are appropriate to those businesses, the "financial integrity" test is meaningless and provides no standard for judicial review. More basically, the "financial integrity" test can protect a firm only when it is applied to an entity that is actually raising capital in the market. Only then does the standard provide an objective check on government depredation — the return investors will insist upon before committing capital. Without that check, the "financial integrity" test is an empty slogan that both invites and cloaks theft from other businesses.

IV. THE AGENCY'S SELECTION OF TELRIC WAS ARBITRARY AND CAPRICIOUS.

The FCC's selection of TELRIC in lieu of an historical cost methodology was also arbitrary and capricious.

1. A blank-slate replacement cost methodology is too unworkable and speculative to serve as the exclusive basis for cost recovery. Less radical replacement cost methods had been discredited on precisely these grounds. Only the most arrogant regulator would presume to predict accurately the evolution of the *entire telephone network* in every particular over 30 to 50 years, in the face of unforeseeable technological change. Forward-looking analysis has been used in setting price *floors* or as a method of *allocating* historical costs. In neither context has forward-looking cost been used to limit historical cost recovery. Nor has it involved hypothesizing the redesign of the entire network.

The FCC chose an extreme, blank-slate approach that magnifies these problems. The FCC removes any objective check on TELRIC by prohibiting consideration of opportunity or historical costs. TELRIC then piles speculation on top of hypothesis by assuming the instantaneous deployment of an optimal network. TELRIC exceeds anything ever countenanced by this Court as a reliable measure of recoverable costs.[15]

---

[15] The FCC's version of forward-looking cost is unlike any seen before. A forward-looking methodology is used to ascertain what will actually be spent over the long run. A key to any forward-looking methodology is the baseline configuration of assets assumed in year one. Usually, the inquiry is into the long-run cost of a defined *increment* of

(Cont'd)

The FCC's rejoinder that several States had previously adopted "the forward-looking approach," and that concerns about workability thus "are largely refuted by practical experience," FCC Br. 47, is debunked above. *See supra* pp. 2-4 & n.2. None of the 14 States relied upon in the Order had implemented a pricing methodology based on the hypothetical replacement cost of the entire network.[16]

The FCC's concerns over the alleged "administrative difficulties" of an historical cost methodology, FCC Br. 48-49, are frivolous. First, the fact that an historical cost methodology requires some effort does not render a blank-slate methodology less speculative or more workable. Just last year, the FCC stated that historical cost pricing "brings certainty to the regulatory

(Cont'd)
output, and thus takes the existing configuration of assets as a given. For example, in determining the long-run incremental cost to CSX of 1 million passenger miles, one could measure the cost of new rolling stock, employees, advertising, *etc.*, *given* existing rail lines, the compatibility of new trains with old trains, and similar factors. *See generally* Alfred E. Kahn, *Whom the Gods Would Destroy, or How Not to Deregulate* 4 (2001). By contrast, a determination of the long-run cost of CSX's *entire rail system* is not an "incremental" inquiry at all — it seeks to measure the total costs that CSX would be expected to incur over the long run. Given the nature of a railroad network, a proper forward-looking analysis would assume a baseline configuration in year one comprised of the existing long-lived capital assets, and then project phased replacement over time. *See* ILEC Resp. Br. 17-22. The FCC's basic mistake – and what is inherently arbitrary about TELRIC — is that it conflates these two distinct approaches. TELRIC asserts that, because CSX will replace its entire system over 30+ years, an "incremental" methodology requires regulators to assume that CSX replaced the entire system *all at once on day one*.

[16] No State cited by the FCC as employing a forward-looking methodology, *see* J.A. 335 (¶ 631 nn.1509-10), had adopted a blank-slate approach, and a number expressly rejected it as inherently unworkable. *See, e.g.*, J.A. 100 (Conn. Comm'n Comments, Att. C at 9-10) (rejecting "scorched node" approach as a "somewhat existential methodology"); *see also In re a Methodology to Determine LRIC*, No. U-10620, 156 P.U.R.4th 1, at Ex. A (Mich. PSC Sept. 8, 1994) ("The least-cost technology is not the 'scorch the earth' approach where you begin from scratch or some hypothetical network that will never exist.").

process" and rejected a forward-looking measure because it would necessitate a "complicated pricing investigation." *Amendment of Rules and Policies Governing Pole Attachs.*, 15 F.C.C.R. 6453, ¶ 25 (2000). Second, the allocation of actual expenditures to the assets that those expenditures actually produced — a task regulators have performed for decades, *see Iowa Bd.*, 525 U.S. at 423 (Breyer, J., concurring in part and dissenting in part) — is infinitely swifter and more certain than virtual reconstruction of the entire network.

2. In TELRIC, the FCC sacrificed the goals of the Act to pursue its own regulatory vision of "efficient competition." The statute's objectives are to open the local market to the process of competition, to encourage investment by all competitors in advanced telecommunications facilities, and fully and fairly to compensate incumbents for the use of their facilities. *See* H.R. Conf. Rep. No. 104-458, at 1 (1996); H.R. Rep. No. 104-204, at 73; *see also Iowa Bd.*, 525 U.S. at 413-18 (Breyer, J., concurring in part and dissenting in part). The FCC contravened these goals by setting UNE prices to *prevent* facilities-based entry in circumstances the agency deemed "inefficient." FCC Br. 42. The FCC thus presumed to substitute its own central plan for the competitive process that the Act envisions. *See* ILEC Resp. Br. 24-25. None of the FCC's asserted justifications for this subversion of the Act's goals can withstand scrutiny.

First, the FCC claims that setting UNE prices at historical costs would send the "wrong" signal, thus prompting "inefficient" entry. FCC Br. 41-42. Yet competitors base their decisions not only on the UNE price, but also on the costs of other potential competitors and the prospect that the incumbent will drop its own prices below historical costs to avoid bypass. Even if the agency's concern about price signals were justified, it would not explain the FCC's refusal to allow historical cost recovery through other means — such as Ramsey pricing or a mechanism separate from UNE rates. *See Iowa Bd.*, 525 U.S. at 423 (Breyer, J., concurring in part and dissenting in part).

Second, the FCC arbitrarily assumed that TELRIC was a better gauge of real forward-looking costs than actual prudent investment. While historical costs have been subject to both prudency review and price caps, TELRIC is, by definition, unattainable. Given its assumption of a network with evergreen optimality, coupled with old-style depreciation and rates of return, no carrier can ever beat TELRIC prices with its own facilities. *See* ILEC Resp. Br. 25-33. Even if a firm could meet TELRIC costs, prices would not immediately drop to that level, as the U.S. Department of Commerce advised the FCC. J.A. 181-82 (NTIA Reply Comments at 23 n.43 ("Commerce Comments")). The FCC simply pronounced that the existing network "reflect[ed] inefficient or obsolete network design and technology," J.A. 383 (¶ 684), *because its costs were higher than the hypothetical TELRIC network.* That conclusion is entirely irrational — no real network can (or should) match TELRIC's ubiquitous optimality. *See* ILEC Resp. Br. 17-22. After five years, the FCC is still unable to specify what these alleged "inefficiencies" are, or how TELRIC may deny recovery based on hypothetical efficiency levels almost 10 times greater than the FCC has found achievable in its price cap orders.

Third, the FCC ignored the danger that setting UNE prices too low was greater than the risk of setting them too high. If prices based on historical costs are too high (*i.e.*, they reflect real "inefficiency"), the market will self-correct as incumbents drop wholesale prices to avoid facilities bypass. On the other hand, if TELRIC sets prices so low that potential facilities-based entrants would instead choose to ride on incumbents' UNEs, real efficiency gains will be lost. *See* J.A. 182 (Commerce Comments at 23) ("[I]f interconnectors receive rates associated with the least cost method of production, none will have the incentive to create its own efficient network."). TELRIC thus deters efficient entry, discourages investment by both incumbents and entrants, and prefers one form of entry (UNEs) over another (facilities).

CONCLUSION

The judgment below should be reversed in part.

Respectfully submitted,

MARK L. EVANS
MICHAEL K. KELLOGG
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

Counsel for BellSouth Corporation, SBC Communications Inc., United States Telecom Association, and Verizon Entities

CHARLES R. MORGAN
JAMES G. HARRALSON
BELLSOUTH CORPORATION
1155 Peachtree Street, N.E.
Atlanta, GA 30309
(404) 249-2641

Counsel for BellSouth Corporation

WILLIAM P. BARR
M. EDWARD WHELAN
VERIZON
1850 M Street, N.W.
Washington, D.C. 20036
(202) 463-5200

PATRICK F. PHILBIN
Counsel of Record
JENNIFER R. BROSNAHAN
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000

MICHAEL E. GLOVER
VERIZON
1320 N. Courthouse Road
Arlington, VA 22201
(703) 974-2944

Counsel for Verizon Entities

ANDREW G. MCBRIDE
SCOTT DELACOURT
KRISTINA R. OSTERHAUS
WILEY REIN & FIELDING LLP
1776 K Street, N.W.
Washington, D.C. 20006
(202) 719-7000

HENRY WEISSMANN
MUNGER, TOLLES & OLSON LLP
355 S. Grand Avenue
Los Angeles, CA 90071
(213) 683-9100

Counsel for Verizon Entities

JAMES D. ELLIS
PAUL K. MANCINI
SBC COMMUNICATIONS INC.
175 E. Houston
San Antonio, TX 78205
(210) 351-3500

ROGER K. TOPPINS
GARY PHILLIPS
SBC COMMUNICATIONS INC.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
(202) 326-8891

Counsel for
SBC Communications Inc.

LAWRENCE E. SARJEANT
LINDA L. KENT
KEITH TOWNSEND
JOHN W. HUNTER
JULIE E. RONES
UNITED STATES TELECOM ASSOCIATION
1401 H Street, N.W.
Suite 600
Washington, D.C. 20005
(202) 326-7371

Counsel for United States
Telecom Association

July 23, 2001